

# **Real Estate Valuation and Analysis**

## **Student's Course Outline**

For use in the 30 hour course designed by the Idaho Real Estate Education Council

**Revised May 2000**

## **REAL ESTATE VALUATION AND ANALYSIS**

**COURSE OBJECTIVE:** This is an *introductory* course covering the purpose of appraisals, the appraisal process and the different approaches, methods and techniques used to determine the value of various types of property. Emphasis will be on employing the process in residential brokerage as opposed to how to perform the process. This course is not designed to provide the student with all the skills and knowledge necessary to embark on an appraisal career, but the student should have an understanding of the concepts and practices in the real estate appraisal field. The student will have a working knowledge of some of the techniques used by appraisers.

**WHAT THIS COURSE WILL DO FOR THE STUDENT:** This 30-hour basic Real Estate Valuation and Analysis course is being taught with the assumption that the students have had minimum exposure to the appraisal field. Students who are more familiar with the appraisal process will undoubtedly find some repetition in this course. Specifically, this course will:

- ✓ Familiarize the student with the basic appraisal theory.
- ✓ Enable the student to evaluate and, if necessary, challenge the appraisal.
- ✓ Enable the student to be more adept in performing market analysis for listing purposes.
- ✓ Alert the student to the dangers of a real estate licensee making an appraisal for a fee.
- ✓ Make the student aware of some of the liabilities that are assumed by having a conflict of interest and possible litigation and liability for errors and omissions.
- ✓ Give the student actual experience completing a “Residential Appraisal Report” form.

### **WHAT THIS COURSE WILL NOT DO FOR THE STUDENT:**

- ✓ Make an appraiser out of the student or enable the student to make an appraisal for clients.

In general, this course is designed to familiarize real estate people and investors with the appraisal process and should be considered only as a stepping stone for those who desire to pursue the subject further. This is a good review of the basic theory and principles for students who are already knowledgeable in the area and desire to sharpen their skills for either further work in the appraisal profession or desire to provide a better service to their clients.

**CLASS APPRAISAL REPORT:** Each student will be required to complete a basic residential appraisal report. At the instructor’s discretion, the subject residence may be viewed by the students; may be presented as a classroom case study, or may be selected from the student’s office files.

The project requires recognition of the effects of city or area growth and structure on the property and its neighborhood. Students should, also, consider the possible effects of planning redevelopment, rezoning, and other public, as well as, private market trends.

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Standard Course Materials:

*Fundamentals of Real Estate Appraisal*, by Ventolo & Williams. Real Estate Education Co.

## **I. THE APPRAISAL PROFESSION**

### **A. The Appraiser's Work**

1. Qualifications of an Appraiser
  - a. Education
  - b. Experience
  - c. Objectivity
2. The Modern Appraisal Office
3. Assignments Available
4. Employment Opportunities
5. Appraiser Compensation

### **B. Licensing and Certification**

### **C. FIRREA**

1. Appraiser Licensing
2. The Appraisal Foundation
3. The Idaho Real Estate Appraiser Board

### **D. Other Federal Regulation**

1. Fair Housing
2. Environmental Concerns
3. Professional Standards of Practice
4. Professional Societies

## **II. REAL ESTATE & ITS APPRAISAL**

### **A. Basic Concepts**

1. What is Real Estate Appraisal?

## 2. Real Estate and Real Property

- a. Land
- b. Fixtures
- c. Trade fixtures
- d. Bundle of Rights
- e. Public Restrictions
- f. Private restrictions

## 3. Personal Property

### B. Legal Descriptions of Land

- 1. Lot and Block System
- 2. Metes and Bounds System
- 3. U.S. Government Survey System

### C. Legal Rights and Interests

- 1. Freehold Estates
  - a. Fee simple estate
  - b. Life estate
- 2. Nonfreehold Estates
  - a. Leasehold estate
  - b. Leased fee estate
- 3. Other Interests
  - a. Easement
  - b. License
  - c. Encroachment

#### D. Forms of Property Ownership

1. Individual Ownership
2. Co-Ownership
  - a. Tenancy in common
  - b. Joint tenancy
  - c. Marital property
  - d. Tenancy in partnership
3. Other Forms in Ownership
4. Special Forms of Ownership
  - a. Condominium
  - b. Cooperative
  - c. Planned unit development

#### E. Transfer of Title

1. Types of Deeds
  - a. Grant deed
  - b. Quitclaim deed
  - c. Warranty deed
  - d. Bargain and sale deed
  - e. Trust deed
  - f. Reconveyance deed
  - g. Sheriff's deed
  - h. Tax deed
2. Recordation

- a. Acknowledgement
- b. Recording

### **III. THE REAL ESTATE MARKETPLACE**

#### **A. The Market for Real Estate**

##### **1. Characteristics of Real Estate Markets**

- a. Immobility of real estate
- b. Availability of information

##### **2. Market Analysis**

##### **3. The Cost of Credit**

- a. Sources of capital
- b. Competing Investments

##### **4. How Real Estate is Financed**

- a. Mortgage terms concepts
- b. Mortgage payment plans
- c. Types of mortgages

##### **5. Elements of Value**

- a. Definition of market value
- b. Sales price
- c. Cost
- d. Investment value
- e. Other values

##### **6. Influences on Real Estate Value**

- a. Physical and environmental

- b. Economic
- c. Government and legal
- d. Social

#### B. Basic Value Principles

1. Substitution
2. Highest and Best Use
3. Externalities
4. Supply and Demand
5. Conformity, Progression and Regression
6. Contribution
7. Law of Increasing Returns and Law of Decreasing Returns
8. Balance
9. Competition
10. Change
11. Growth, Equilibrium, Decline and Revitalization
12. Opportunity Cost
13. Theory of Distribution
14. Surplus Productivity
15. Anticipation

### **IV. THE APPRAISAL PROCESS**

#### A. Steps in the Appraisal Process

#### B. Beginning the Appraisal Process

1. Purpose and Use of the Appraisal

2. Interest(s) to be Appraised
3. Date of the Value Estimate
4. Limiting Conditions

C. Valuation Approaches

1. Sales Comparison Approach
2. Cost Approach
3. Income Capitalization Approach

D. Relationship of Approaches

**V. BUILDING CONSTRUCTION & THE ENVIRONMENT**

A. Part I: Planning and Design

1. Regulation of Residential Construction
2. Plans and Specifications
  - a. Building Measurement
    - (1) Gross living area
    - (2) Gross building area
    - (3) Gross leasable area
3. House styles
  - a. Traditional styles
  - b. Contemporary styles
4. House Types
  - a. The one-story house
  - b. The one-and-a-half-story house
  - c. The two-story house

- d. The split-level house
  - e. The split-entry house
  - f. Factory-built houses
5. Orientation: Locating the House on the Site
- a. Facing to the south
  - b. View

B. Part II: Construction Details

- 1. Foundations
  - a. Concrete slab
  - b. Pier and beam
- 2. Termite Protection
- 3. Radon Gas
- 4. Exterior Structural Walls and Framing
  - a. Exterior Walls
  - b. Insulation
- 5. Roof Framing
  - a. Exterior Trim
- 6. Exterior Windows and Doors
  - a. Types of windows
  - b. Types of doors
- 7. Interior Walls and Finishing
- 8. Plumbing
- 9. Heating and Air-Conditioning

- 10. Electrical System
  - a. Power Requirements
  - b. Electric and Magnetic Fields

## **VI. DATA COLLECTION**

- A. Step 1: State the Problem
  - 1. Property Rights Conveyed
- B. Step 2: List the Data Needed
- C. Step 3: Gather, Record and Verify the Necessary Data
- D. The Data Source List
  - 1. Kinds of Data Needed
    - a. National and regional trends
    - b. Economic base
    - c. Local area and neighborhood
    - d. Site and improvements
- E. Data Forms
  - 1. Neighborhood Data
    - a. Stage of life cycle
    - b. Proximity to hazards and nuisances
  - 2. Site Data
  - 3. Building Data
    - a. Exterior features
    - b. Interior features
    - c. Depreciation

- d. Multi-unit buildings

- F. Data for Sales Comparison Approach

- 1. Recent Sales
- 2. Similar Features
- 3. Financing Terms
- 4. Arm's-Length Transactions
- 5. Sources of Data

## **VII. SITE VALUATION**

- A. Separate Site Valuations

- 1. Cost Approach
- 2. Assessments and Taxation
- 3. Condemnation Appraisals
- 4. Income Capitalization
- 5. Highest and Best Use
  - a. Four test
  - b. Vacant (or as if vacant)
  - c. As improved
  - d. Interim use

- B. Site Data

- 1. Identification
- 2. Analysis

- C. Environmental Concerns

- D. Methods of Site valuation

1. Sales comparison method
2. Allocation method
3. Abstraction (extraction) method
4. Subdivision development method
5. Ground rent capitalization method

## **VIII. THE COST APPROACH – PART I:**

### **REPRODUCTION/REPLACEMENT COST**

- A. Cost Approach Formula
- B. Reproduction Cost versus Replacement Cost
- C. Finding Reproduction/Replacement Cost
  1. Index Method
  2. Square-Foot Method
    - a. Regional multipliers
    - b. Residential appraisals
  3. Unit-in-Place Method
  4. Quantity Survey Method

## **IX. THE COST APPROACH – PART II: DEPRECIATION**

- A. Accrued Depreciation
  1. Age-Life Method
    - a. Variations of the age-life method
  2. Observed Condition Method
  3. Capitalized Value Method
  4. Sales Comparison Method

5. Itemizing Accrued Depreciation

- a. Cost data
- b. Depreciation data
- c. Site value

6. Cost Approach Using the URAR Form

**X. THE SALES COMPARISON APPROACH**

A. Step 3: Gather, Record and Verify the Necessary Data (continued)

1. Comparison Grid

- a. Sales or financing concessions
- b. Date of sale/time
- c. Location
- d. Leasehold/fee simple
- e. Site/view
- f. Design and appeal
- g. Quality of construction
- h. Age
- i. Condition
- j. Above-grade room count/gross living area
- k. Basement and finished rooms below-grade
- l. Functional utility
- m. Heating/cooling
- n. Energy-efficient items
- o. Garage/carport

- p. Porch, patio, deck, fireplace(s), etc
- q. Fence, pool, etc

B. Step 4: Determine Highest and Best Use

C. Step 5: Estimate Land Value

D. Step 6: Estimate Value by Sales Comparison Approach

- 1. Data Analysis

- a. Types of adjustments

- (1) Matched pairs analysis

- (2) Percentage

- b. Compute adjustment values

- c. Time adjustment

- d. Highway location

- e. Commercial area

- f. Sequence of adjustments

- g. Record information

- 2. Net and Gross Adjustments

- 3. Value Estimate

E. Application of Sales Comparison Approach

## **XI. THE INCOME CAPITALIZATION APPROACH**

A. The Income-Based Approaches to Appraisal

B. Potential Gross Income

- 1. Rent

- a. Scheduled (contract) rent

- b. Historical rent
    - c. Economic or Market Rent Stabilized Rent
  - 2. Outside Economic factors
  - 3. Other Income
  - 4. Gross Income and Gross Rent Multipliers
  - 5. Applying the GRM to Residential Properties
  - 6. Income Approach Using the URAR Form
- C. Effective Gross Income
- D. Net Operating Income
  - 1. Classification of Operating Expenses
  - 2. Expenses for Accounting Purposes versus Expenses for Appraisal Purposes
  - 3. Reconstructing the Operating Statement
  - 4. Operating Statement Ratios

## **XII. DIRECT & YIELD CAPITALIZATION**

- A. Direct Capitalization Formula
- B. Capitalization Rate
  - 1. Building a Capitalization Rate
  - 2. Selecting the Rate for Capital recapture
    - a. Straight-line method of recapture
  - 3. Selecting the Interest Rate by the Market Extraction Method
- C. Band of Investment Method-Mortgage and Equity Elements
  - 1. Relationship of Capitalization Rate and Risk

- D. Capitalization Techniques Using Residual Income
  - 1. Building Residual Technique
  - 2. Land Residual Technique
  - 3. Valuing the Land and Building as a Whole
- E. Yield Capitalization
- F. Value of One Dollar
- G. Annuity Method of Capitalization
- H. Recapture Rates
- I. Ellwood Tables

### **XIII. Reconciliation & The Appraisal Report**

- A. Definition of Reconciliation
  - 1. The Process of Reconciliation
  - 2. Review of the Three Approaches
  - 3. Weighing the Choices
- B. Reconciliation is Not...
- C. Types of Appraisals
- D. Types Appraisal Reports
- E. Styles of Written Appraisal Reports
  - 1. Form Style Report
  - 2. Narrative Style Report
  - 3. Introduction
    - a. Title page
    - b. Letter of transmittal

- c. Table of contents
- d. Summary of important facts and conclusions
- 4. Supposition of the Appraisal
  - a. Type of appraisal and report format
  - b. Purpose of the appraisal
  - c. Definition of value
  - d. Date of value estimate
  - e. Property rights
  - f. Statement of assumptions and limiting conditions
- 5. Presentation of Data
  - a. National, regional and city data
  - b. Neighborhood data
  - c. Financing
  - d. Site data
  - e. Utilities
  - f. Zoning
  - g. Amenities
  - h. Description of improvements
  - i. Taxes
  - j. Sales history
- 6. Data Analyses and Conclusions
  - a. Highest and best use analysis
  - b. The cost approach

- c. The sales comparison approach
- d. The income capitalization approach
- e. Reconciliation and final conclusion of value
- f. Certification of appraiser
- g. Qualifications of appraiser
- 7. Supporting Material
  - a. Addenda

F. Sample Appraisal Report

**XIV. Appraising Partial Interests**

A. Types of Partial interest

- 1. Condominiums
- 2. Planned Unit Developments
- 3. Time-Share Projects
- 4. Manufactured Homes
- 5. Other Forms of Ownership

B. Appraising Lease Interests

- 1. Definition of Terms
  - a. Leased fee
  - b. Leasehold estate
  - c. Sandwich lease
- 2. Creation of Lease Interests
- 3. Leased Fee and Leasehold Valuations